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TAGS: ECON EFIN VE
SUBJECT: VENEZUELA'S DEBT: MANAGEABLE FOR NOW

REF: A. CARACAS 1209
 B. CARACAS 304
 C. CARACAS 368
 D. CARACAS 494

11. (SBU) Summary: As of June 30, Venezuela's sovereign external debt officially stood at USD 30 billion and its internal debt at 44 billion bolivars (USD 20 billion at the official exchange rate). These levels appear quite manageable given the size of Venezuela's economy. However several factors make Venezuela's debt situation somewhat more problematic than the numbers above indicate. There has been a significant increase in internal debt over the course of the year, which could lead to higher inflation if the trend continues. On the external side, the official numbers do not take into account what are presumably large sovereign obligations to China (for the China-Venezuela joint fund) and potentially to Russia (for arms purchases). Venezuelan debt is considered one of riskiest of the major Latin American economies, making further external issuances more expensive. Finally, PDVSA, the state-owned oil company, has increased its debt substantially in recent years with little to show for it. End summary.

By the Numbers

12. (U) According to the Ministry of Economy and Finance (MEF), on June 30, 2009, Venezuela's external debt stood at USD 29.9 billion and its internal debt at USD 20.5 billion (when converting bolivars (Bs) to USD at the official rate). According to PDVSA's 2008 audited financial statement, as of December 31, 2008, PDVSA's debt stood at USD 13.5 billion (all denominated in hard currencies). The table below shows the amortization profiles of government and PDVSA debt, with the addition of USD 3 billion in zero coupon debt PDVSA issued in July 2009 that matures in 2011. (Note: This table does not include the USD 3 billion in sovereign external debt whose issuance is currently being processed. We will report on this issuance septel. End note.)

Year	GBRV	PDVSA
	External	Internal
2009	0.7	2.0
2010	2.2	1.5
2011	2.3	1.9
2012	0.7	3.1
2013	2.1	2.4

Beyond	21.9	9.2	9.8
Total	29.9	20.1	16.5

¶13. (U) By conventional standards, this debt level is quite moderate. Venezuela's external debt as of June 30, 2009, represented only 10 percent of its 2008 GDP (as expressed in dollars at the official exchange rate) and 32 percent of its 2008 exports. In contrast, Colombia's external debt at the end of the first quarter of 2009 represented about 13 percent of its 2008 GDP and 67 percent of its 2008 exports. PDVSA's USD 16.5 billion in debt is about 13 percent of its stated 2008 revenues.

What the Numbers Don't Reveal

¶14. (SBU) The numbers presented above do not take into account a number of factors, which, when taken together, make Venezuela's debt situation appear somewhat less rosy, though still quite manageable. First, the MEF's external debt statistics do not take into account several key obligations of the Government of the Bolivarian Republic of Venezuela (GBRV). These include the China-Venezuela joint fund, for which many observers believe China (through the China Development Bank) has loaned the GBRV USD 8 billion, and credit possibly extended by the Russian government to finance GBRV arms purchases (ref A). As these and similar deals lack transparency, there is no way of knowing how much the GBRV owes to whom and at what interest and maturity. There are also a number of pending international arbitration cases over GBRV expropriations that may result in significant GBRV

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obligations.

¶15. (U) Second, any comparison of Venezuela's external debt to GDP begs the question of what exchange rate to use when converting Venezuela's GDP to dollars. Using the official exchange rate (2.15 Bs/USD), which is clearly overvalued and becoming increasingly less relevant to Venezuela's economy (ref B), makes Venezuela's GDP appear artificially high and the debt to GDP ratio artificially low. In contrast, the parallel exchange rate is currently 5.6 Bs/USD. Using a more realistic exchange rate and including an estimate for the GBRV's other external obligations, Venezuela's external debt to GDP ratio could easily be above 20 percent - still manageable, but not as good as a cursory analysis would suggest.

¶16. (SBU) Third, looking at debt levels hides two problematic trends related to flows. The GBRV has chosen to finance its 2009 deficit by issuing large amounts of internal debt. The National Assembly in March approved issuance of up to Bs 34 billion (USD 15.8 billion at the official exchange rate) in internal debt in 2009 (ref C), and the GBRV issued Bs 11.5 billion of internal debt in the second quarter. If the GBRV continues to issue internal debt at this pace, internal debt will approximately double over the course of 2009 (from roughly USD 15 to 30 billion at the official exchange rate). While this trend may lead to greater inflationary pressures in the future, it does not involve any dollar constraints and is less problematic than a similar increase in external debt would be. The second problematic trend is the increase in PDVSA's debt without a corresponding increase in crude oil production (or, to all appearances, investment). PDVSA's debt has grown from just over USD 2 billion at year-end 2006 to USD 16.5 billion today. Again, the level is manageable given PDVSA's recent revenue stream and the current price of oil. However, the money raised has not been used for new investment and PDVSA's output has been falling, trends which raise serious questions about PDVSA's management.

¶17. (SBU) Finally, it is costly for the GBRV or PDVSA to issue new external debt. Venezuela generally beats out

Argentina for the dubious honor of having the highest sovereign risk of a major Latin American economy, and most of its bonds are currently yielding in the 11-13 percent range. PDVSA bonds are considered even riskier and have a slightly higher yield. Our conversations with analysts indicate Venezuela's risk is high - despite Venezuela having an excellent repayment record - because of President Chavez's unpredictability, concerns about Venezuela's economic model, and the GBRV's lack of transparency. (Note: It is not costly at the moment for the GBRV to issue new internal debt.

The real interest rate is negative (a byproduct of currency controls and monetary policy), and the Central Bank has ensured the necessary liquidity for banks to buy the debt (ref D). End note.)

Comment

¶8. (SBU) As with most economic matters in Venezuela, the parts of the GBRV's debt strategy that make little economic sense have a political explanation. For example, conventional economics would suggest the GBRV ought to close its 2009 deficit, at least partially, by devaluing rather than doubling its internal debt. For Chavez, however, to devalue would be to admit defeat (ref B). Similarly, it is hard to believe Chavez would ever voluntarily take the necessary steps to bring down the yield on sovereign external debt. These steps would almost certainly benefit Venezuela's economy, but they would reduce Chavez's control and discretionary power. As Venezuela's debt levels are manageable, he will probably not be forced to take such steps in the near future. End comment.

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